and entered January 21, 1941 to the end that its judgment be reversed with directions to reverse the order of the District Court which dismissed petitioners' action for want of jurisdiction and that the respondents be required to answer on the merits.

Respectfully submitted,

MEYER ABRAMS,
JOSEPH L. STERN,
HARRY J. MYERSON,
Counsel for Petitioners.

BRIEF IN SUPPORT OF PETITION.

Jurisdiction to Grant the Writ.

The jurisdiction to review the order of the Seventh Circuit is invoked under Section 240(a) of the Judicial Code as Amended by the Act of February 13, 1925 (43 Stat. 1938, 28 U. S. C. A. Sec. 47). The order of the Seventh Circuit affirming the order of the District Court was entered on January 21, 1941, and the petition is filed within the statutory period.

Opinions Below.

The Seventh Circuit rendered an opinion on January 21, 1941 (R. 70) which consists of one paragraph and which was published in 117 F. (2) 259. This opinion adopted by reference the opinion of the District Court which was published in 35 F. Supp. 508 (R. 42-60).

The question involved in this petition was incidentally presented to the Sixth Circuit in an appeal taken by these Petitioners in connection with the suit commenced by them in the District Court of Ohio. (*Gochenour et al.* v. *Cleveland Term. Bldg. Co.*, Case No. 8708, decided

March 3, 1941.) The Sixth Circuit reversed the order of the District Court in part and remanded the case with directions. On the issue, however, as to whether or not the cause of action belonged to the Debtor, it held that the right of action exclusively belonged to the Debtor and that Petitioners had no right to maintain the action. The opinion was rendered March 3, 1941, and is not yet final as the time for rehearing will not expire until April 3, 1941, and if it is made final we intend to present that opinion to this court on an application for a Writ of Certiorari.

Statement of the Case.

This is an action brought by a distinct class of creditors of The Cleveland Terminals Building Company, an Ohio corporation. Plaintiff, A. B. Gochenour and the other ten plaintiffs are residents of states other than Indiana. The defendant, George and Frances Ball Foundation, a corporation, and the individual defendants, are residents of Indiana. Plaintiffs sought to recover from the defendants over $6,000,000.00, which the defendants obtained as stockholders of Midamerica Corporation, the principal defendant in their main suit pending in the District Court of Ohio. This suit was ancillary to the Ohio suit, due to the nonresidence of the defendants there.

In the month of August, 1935, O. P. and M. J. Van Sweringen (now deceased), together with one, Charles L. Bradley (principal officers and directors of the Debtor) entered into a conspiracy with the Indiana defendants, George A. Ball and F. B. Bernard and others, for the purpose of defrauding the plaintiffs, the then existing creditors of the Debtor (R. 3). On October 31, 1930, the Debtor had executed its note for $23,500,000.00, secured by collateral consisting of Alleghany Common Stock and other securities. This note, together with the

collateral, was delivered by the Debtor to its Parent, the Vaness Company, which owned all of the stock of the Debtor. At the same time "Vaness" executed its note for $16,000,000.00, secured by other collateral. O. P. and M. J. Van Sweringen and Charles L. Bradley (who controlled the "parent" and "child") delivered both notes, as well as all of the collateral, to J. P. Morgan & Co. as security for a loan.* The collateral remained with "Morgan" until September 30, 1935, when it was sold at an alleged auction to a corporation, organized on the eve of the sale, under the name of Midamerica Corporation by the Van Sweringen interests, the Ohio residents, and the Ball interests, the defendant herein (R. 3-4).

The Debtor was insolvent at the date of the sale (R. 3). Its principal officers stood then in the relation of trustees for the plaintiffs, the existing creditors. It became their duty as such trustees to exert every effort to protect the collateral for the benefit of such creditors. Knowing of the scheduled sale and concealing it from the creditors, they entered into a conspiracy with the defendants to create the Midamerica Corporation and to purchase in its name the collateral for their personal gain and profit. The Midamerica Corporation was organized pursuant to said conspiracy on September 25, 1935. They elected O. P. Van Sweringen as Director and President and M. J. Van Sweringen and Charles L. Bradley as Directors and Vice-Presidents. The defendants, G. A. Ball and F. B. Bernard were also elected as Directors. Said O. P. Van Sweringen was authorized to purchase on behalf of Midamerica the collateral, and he purchased in its name the collateral pledged under the $23,500,000.00 note at the price of $318,000.00. This collateral had then an actual market value in the sum

* The legality of the loan was the subject matter of an appeal taken by the same petitioners and it was determined that as to $5,000,000 of the loan there was fraud (Gochenour v. J. P. Morgan & Co., 111 F. (2) 378.

of $2,134,068.15. They realized an immediate profit on the basis of the then market value of $1,816,068.75 which increased in value thereafter to over $6,000,000.00. They realized from the sale of the collateral $6,805,800.00. Thereafter, the defendants, George A. Ball and F. B. Bernard, acquired all of the stock of Midamerica Corporation, and said Midamerica Corporation distributed the proceeds realized from the sale of the collateral to the defendants, including George and Frances Ball Foundation, a corporation, created by said Ball and Bernard (R. 4-6).*

Midamerica also purchased at that sale one claim against the Debtor in the amount of $13,787,000.00 at the price of $887.00, and another claim of $1,348,614.99 at the price of $2.00. After acquiring the aforesaid assets and realizing the profit thereon, it filed these claims against the Debtor in the 77B proceedings, and the Respondent, George and Frances Ball Foundation, appeared in that proceeding seeking to sustain the claim (R. 36-37). The court denied the claims as requested in the sum of $15,135,614.99 and only allowed the claimant to recover the purchase price in the sum of $889.00 (R. 37). In denying such claims the Court found that Midamerica on the occasion of its purchase "was a combination in corporate form participated in by the directors of The Cleveland Terminals Building Company" for the purpose of divesting it of its property and of "obtaining claims against said The Cleveland Terminals Building Company" at the expense of the Debtor (R. 61). However, no action was taken to recover the $6,000,000.00 in profits realized by it and the Respondents as a

* For the history of the "Morgan" sale, the creation of "Midamerica" and "Ball Foundation" see the following Reports of the Senate Committee under Resolution 71 of December 19, 1940:

Report No. 25, Part 25, entitled: Alleghany System—Midamerica Corporation: Its Uses as a Holding Company.

Report No. 25, Part 26, entitled: Alleghany System—Sale by George A. Ball: Tax Avoidance Through Charitable Foundations.

Report No. 25, Part 27, entitled: Alleghany System—Acquisition of Control by Robert R. Young.

result of their conspiracy and the statutory period of limitation of Ohio expired September 30, 1939.

Petitioners filed their suit in Ohio on September 11, 1939, within the statutory period (R. 18), and they commenced this suit in October, 1939 (R. 1-8). They alleged in their complaint in this cause that the Petitioners, prior to the institution of this suit, commenced a similar action against Midamerica Corporation, but due to the fact that the defendants to this cause were non-residents in Ohio it was necessary to commence this action in Indiana. It stated that Debtor was a proper party plaintiff or defendant, but due to the fact that it was administered by the District Court at Ohio under Section 77B it was necessary to obtain leave of that court to join it as a party; that an application was made to that court to join it as a party; that the court determined that the Debtor was neither a proper, necessary nor indispensable party (R. 7).

The motion of the Respondents (R. 12) to dismiss this cause because the right of action was not vested in them but in the Debtor was sustained by the Court on February 15, 1941 (R. 36), and was affirmed by the Seventh Circuit on January 21, 1941 (R. 71).

ARGUMENT.

I.

The cause of action is not derivative from the Debtor and was properly brought by the petitioners as a distinct class of creditors. The decision that such a cause passed to the Debtor in its capacity as trustee under 77B is in conflict with other decisions, and with fundamental law.

In deciding that the cause of action was derivative, and belonged to the Debtor, the opinion of the trial

Court which was adopted by the Seventh Circuit, states (R. 60):

> "It is clear that a 'cause of action' is an asset or a property right of the individual to whom it belongs. It is equally clear that, under the Bankruptcy Act, the title to a 'cause of action' which belonged to the individual prior to bankruptcy passed to the trustee in bankruptcy upon adjudication."

The Court overlooked the fact that this was *not an action which belonged to the bankrupt* prior to its bankruptcy, but belonged to the plaintiffs as a *distinct class* of creditors, not common with other creditors or with stockholders, and that *such an action is not derivative* and is not an asset of the bankrupt.

(a) The decision in the instant case that an action for fraud available to a fraction of the creditors passes to a Debtor in possession in its capacity as Trustee in Bankruptcy is in conflict with decisions from other Circuits.

The decision holds that an action for fraud to a distinct class of creditors passes to a Trustee in Bankruptcy or to a Debtor in possession which stands in such capacity. This is *in direct conflict* with the decision of the Ninth Circuit in *Hirschfeld* v. *McKinley,* 78 F. (2) 124, where the Court reached the *opposite* conclusion. It said:

> "The Trustee in Bankruptcy, of course, represents all the creditors and cannot bring a fraud action on behalf of only a fraction of them."

and concluded that no such action passes to a Trustee in Bankruptcy. Certoriari was denied here (297 U. S. 703).*

The Second Circuit adopted the same view in *Harwood* v. *United States Shipping Board,* 32 F. (2) 680. There,

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* This case is relied on as authority for the proposition that a trustee under 77B is not vested with the right of action for fraud to creditors in Gerdes on Corporate Reorganization (1937 Supp., Sec. 405).

it held that a cause of action for fraud to a distinct class of creditors does not pass to the Trustee in Bankruptcy and can only be maintained by such creditors. It applied this doctrine to Section 77B in *Re 1775 Broadway Corporation,* 82 F. (2) 186. Its recent decision in *Hackner* v. *Guaranty Trust Company of New York,* 117 F. (2) 95, pending here on Certiorari in Case Number 799, seems to hold the same view.* In fact, the Seventh Circuit arrived at a similar conclusion in *Re Diversey Building Corporation,* 86 F. (2) 456, and its decision there that a cause of action by creditors against third parties is available to such creditors only and is not within the jurisdiction of the Bankruptcy Court cannot be harmonized with the decision in the instant case.

The opinion of the Sixth Circuit in the appeal from the other suit by these petitioners which is not yet final cited a decision from the Eighth Circuit holding that claims for fraud available to a fraction of the creditors pass to the Trustee in Bankruptcy (*In Re Bothe,* 173 F. 597).** We recognize that there is a direct conflict between the several circuits and the writ should be issued to settle an important federal question.

(b) The cause of action was predicated on fraud by third parties to a distinct class of creditors, not common with stockholders or other creditors, and such a cause is not derivative, and the distinct class of creditors defrauded had the right to maintain the action in their name.

This was a cause of action belonging purely to the class of creditors who were defrauded and not to the Debtor. This was squarely held in an earlier case by

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* The subject matter in that suit involved the notes in the amount of $13,787,000.00 which Midamerica acquired from "Morgan" at the price of $887.00.

** The contrary was held in *Babbit* v. *Read,* 236 Fed. 42, certiorari denied 243 U. S. 648.

the Seventh Circuit in *Boyd* v. *Schneider,* 131 F. 223. There, the cause of action was for the fraud of the directors in paying out dividends when in fact no such dividends were earned. In determining that this was *not a derivative action* but an action belonging *to the creditors who were defrauded,* this Court said:

> "It seems clear to us that on such state of facts, the directors are answerable in some kind of action, *directly to the persons to whom their duty ran.*"

This Court further said:

> "On the whole matter our conclusion is, that considering arguendo that the receiver might have brought the action stated in the bill, his right to bring such action is not exclusive; and that, to the extent the *directors are responsible specially to the depositors, the depositors have a right of action*— an action, adequate to the fulfillment of the obligation due the depositors by the directors." (Italics ours.)

This applies with equal force here.

A general statement of the rule applicable to this situation is to be found in Fletcher, Cyclopedia Corporations, Vol. 3, Sec. 1313 (1931 Edition), wherein the writer of the text states:

> "The corporation is not a necessary party * * * where the right to proceed against the officers never belonged to the corporation and was no part of its assets * * *
>
> "* * * the corporation need not be made a party where * * * the plaintiffs have no claim against the company. And where plaintiffs' cause of action is for deceit practiced on them by corporate officers, the latter only are liable in damages." *

In *Baily* v. *Ramsey,* 285 Pa. 521, the suit was by creditors against the directors of a corporation to declare the directors as trustees for moneys diverted by them. The Court said (p. 526):

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* See also the application of the rule to 77B in Gerdes on Corporate Reorganization, Section 405 (1937 Supp.).

> "Plaintiffs' cause of action is for a deceit practiced on them by defendants; hence the former alone are interested in the recovery, and only the latter are liable in damages. Under such circumstances, the corporation would not have been a proper party."

In *Dewing* v. *Perdicaries,* 96 U. S. 193, the distinction was well pointed out between a right of action which belongs to the corporation and where the corporation is an indispensable party, and the right of action which is available to an individual and where the corporation may be a proper party but not a necessary or indispensable party. The test in such case is *whether the entire cause of action wholly belongs to the corporation* or the cause of action belongs to *a particular class* as distinguished from the corporation. In that case a shareholder brought an action, and the question was whether the action could be maintained in his own name, and the Court there said (p. 196):

> "Where a cause of action affects the entire interests of a corporation as such, the corporation is the proper party to sue. Where it affects specially a stockholder, he has the same right to sue *pro interesse suo* as any one else. In the latter case, it may or may not be necessary to make the corporation a party. As between the complainant and the party who bought his stock at the pretended sale, the conflict was primarily between them. The question was one of *meum* and *tuum.*"

The distinction was also clearly set out in *Winn* v. *Harby,* 172 S. E. 135 (S. C.).

(1) Only such creditors who were defrauded by the common scheme and who had no notice of the facts may maintain the action, to the exclusion of those who participated therein, knew the facts, and permitted the acts to be performed.

Creditors who were defrauded by a common scheme or device may maintain a class suit against the persons

who defrauded them and the right of action is vested in such creditors and is *not in common with those who were not defrauded* (*Chesbrager* v. *Woodwerts,* 195 F. 875, 880, C. C. A. 6; *Railway Express Agency* v. *Jones,* 7th Cir., 106 F. (2) 341. The Second Circuit recently held that there can be no common action for fraud and that the right belongs to each creditor *separately* (*Hackner* v. *Morgan,* 117 F. (2) 95). In that case the Court even held that creditors lacking the jurisdictional amount may not join with a creditor who has the jurisdictional amount under Rule 23(c) on the ground that each fraud claim was separate and distinct. This suit involved an action for fraud pertaining to a $30,000,000.00 note issue of the Van Sweringen Corporation, $13,787,000.00 of which notes were sold to Midamerica at the "Morgan" sale involved here. If it be true that the fraud action is "derivative" the court could not have reached the conclusion that the suit did not involve a class action. It is true that we applied for a certiorari here in that case, but we did not contend that the action did not belong to the creditors.

(2) The theory that after insolvency the directors are trustees for the creditors only, excludes the corporation as a plaintiff, and it may only be a nominal party, but the action is only available to the creditors.

The Court had for its consideration the cause of action as asserted in the complaint. *It was not asserted that the Debtor was defrauded.* On the contrary, the Debtor, through its officers, *was a party to the fraud.* The cause as stated was, that the directors were trustees, *after insolvency, not for the Debtor but for the plaintiffs as creditors.** This was not a cause of action common be-

* See *Conway* v. *Bonner,* 5th Cir., 100 F. (2) 786 (certiorari denied 307 U. S. 632) where the court made such a distinction and concluded that the right of action was not in the Bankruptcy Trustee.

tween the stockholders and creditors, but was in favor of the particular class of creditors who were *in esse* at the date of the alleged fraud. It was not a cause of action which was available to all creditors but only to the creditors who had no notice of the fraud. If the transaction occurred while the corporation was solvent the right of action would have been in the corporation as the directors of the corporation during solvency stand as trustees for the stockholders. The rule is different, however, *after insolvency* when the directors become *trustees for the creditors only.* The rule was adopted in Ohio (*Young Love* v. *Lime Co.,* 49 O. S. p. 663; *Thomas* v. *Matthews,* 94 O. S. 32, 47), and the Ohio law is controlling on the validity of the claim. The term "derivative" does not apply to an action based on the trust theory (*Hubbard* v. *United Utilities Telephone Co.,* 115 N. Y. 1016).

In *Dunning* v. *Bates,* 186 Mass. page 123, the plaintiffs, as bondholders, sued the trustees for malfeasance and misfeasance without bringing the suit in the name of the corporation and without joining the corporation. A demurrer was filed to the complaint and one of the points upon which the trial court sustained it was that the action was derivative. In overruling this contention the court pointed out that this was a suit between beneficiaries against their trustees, and the corporation was merely an instrumentality but was not the party in whom the cause lodged. The Court said (p. 310):

> "Neglect or misfeasance of trustees is a breach of duty toward the *cestui que trust,* for which they are entitled to a remedy directly against the trustees, under the agreement to which they and the trustees were the only parties."

The Court said:

> "We have no doubt that the bondholders may proceed directly against the trustees to obtain a remedy for a failure to account in a case of this kind."

(3) The gravamen of the complaint was based on a conflict of interests between the plaintiffs as existing bona fide creditors and other creditors who stood in a different class. There being no community of interest among the classes, the corporation was not the representative of the plaintiffs, and the action was properly commenced in their name.

In *Baltimore, C. & A. Ry. Co.* v. *Godffroy,* 4 Cir., 182 F. 525, the Court held that a corporation is the representative of the stockholders "when the claim of the complainant relates to matters common to all classes," where they have "a community of interest," but where the suit "involves a conflict" between different classes, then "the representative character of the corporation ceases." The Court quoted from various decisions and pointed out that "the foundation" of the rule that the corporation is the representative of the class is based on *"a community of interest"* but where the *"gravamen of the complaint consists of vital conflict of interest"* between the different classes "the rule concerning the representative character of the corporation ceases." This case was cited with approval in *Green* v. *Brophy,* 110 F. (2) 539 (1940) on the point that a Trustee is not the representative of the beneficiaries where the interest is in conflict.

II.

The exclusive jurisdiction under 77B was confined to the res administered there, and not to the action in personam against the Indiana residents, and if such jurisdiction existed it was surrendered to the petitioners as creditors.

The entire theory that the Debtor stands in the position of a trustee in bankruptcy and that the cause of

action is therefore in it, is founded on the mistaken idea that the positions of a Debtor and a Trustee in Bankruptcy are identical. The Debtor stands in the position of a trustee in the sense that it must account as trustee for the administration of the property. Its acts as trustee are confined to the administration of the *res*. A corporation which committed fraud against the creditors cannot be transformed, by any device, to a plaintiff on the part of the defrauded party. In *United States* v. *Tacoma Oriental S. S. Co.,* 86 F. (2) 363, it was said:

> "We believe that the act giving exclusive jurisdiction of the lower court over the debtor's property wherever located simply means that the *res* (the debtor's property) is to be considered solely under the jurisdiction of the lower court. Any wrongful invasion, interference, or disposition of that *res* is to be dealt with solely by the lower court. Jurisdiction over a person outside the lower court's jurisdiction, is given to the lower court, only if such person is in some manner invading, interfering, or disposing of the debtor's *res,* and then only to the extent of preventing or forestalling the invasion, interference or disposition of such *res.*"

The case is cited with approval in *Thompson* v. *Terminal* v. *Terminal Shares,* 8 Cir., 104 F. (2) 1, 8.

Under no stretch of the imagination could it have been the intent of Congress to vest the right of action of the defrauded parties in the person or corporation which committed the fraud.

(a) The Debtor having refused to prosecute the cause of action, the right accrued to the plaintiffs as creditors.

The identical question was decided adversely to the decision in this cause by the third circuit in *Monarch Anthracite Mining Co.* v. *Coffin,* 102 F. (2) 337. There, creditors filed a suit against third parties. The "main

averment" was that the defendants "through their control" of the Debtor, which was involved in 77B proceedings, "so manipulated its affairs" that its property and assets "have been wrongfully diverted to the defendants." In disposing of the contention that the creditors had no right to maintain the action and that the action was in the Debtor, the Court said (p. 339):

> "The bill was filed as a class bill under Equity Rule 38, 28 U. S. C. A. following section 723. It is well settled that an injured party may bring a bill to redress the injury complained of, either in his own name or as a class bill under Rule 38, when the corporation, in which is the right of action, refused to act. Equity Rule 27, 28 U. S. C. A. following section 723, regulates this in cases of stockholders, but we have no rule regulating creditors' bills. Rule 23 of the New Rules of Procedure, 28 U. S. C. A. following section 723c, gives recognition of the right."

This is on all fours as the answer of the Debtor (R. 27) constituted a refusal to act. See also *Savage Wholesale Grocery Co.* v. *Republic Ins. Co.* (Texas), 70 S. W. (2) 663.

(b) The Order entered in the 77B proceedings that the Debtor was neither a proper, necessary nor indispensable party to the cause of action as stated in the complaint, constituted an adjudication that such cause of action did not belong to the Debtor and a relinquishment of any claim to jurisdiction.

The complaint, in the Ohio suit, alleged that the Debtor should be joined as a party plaintiff or defendant but that no such joinder can be made without leave of the Bankruptcy Court due to the fact that it was administered under Section 77B. This allegation was made pursuant to the Civil Practice Act (Rule 19(c)).

A petition (R. 15) was presented in the 77B proceeding asking leave to join the Terminals Company as a plaintiff or defendant, based on the complaint, which was attached to the petition (R. 18). The answer of the Debtor (R. 27) was to the effect that it had no objection to being joined as a defendant provided no relief is sought against it. *It believed, however, that there were no prospects for recovery* (R. 28). The creditors' committee filed a memorandum asserting that the cause of action was in the plaintiffs, as creditors, and that the Debtor was neither a proper, necessary nor indispensable party (R. 32). The Master rendered his report on these pleadings. He recommended the denial of the petition on the ground that the Debtor was neither a proper, necessary, or indispensable party (R. 25), and the Court sustained this report (R. 29).

The decision in the 77B proceedings that the Debtor was neither a proper, necessary nor indispensable party to the cause of action as stated in the complaint (which complaint was the basis for the prayer to join it as a party) *constituted an adjudication that the cause of action belonged to the plaintiffs as creditors* and not to the Debtor and was *a relinquishment of any claim to the cause of action* by the Court under Section 77B. The Court clearly wrongfully construed the effect of the order.

(c) The adjudication in the 77B proceeding that the Debtor was not a proper party to the action commenced by the plaintiffs can only be reconciled with a determination and adjudication that the cause of action belonged to the creditors.

The complaint in the instant case alleged that the District Court at Ohio adjudicated that the Debtor was neither a proper, necessary nor indispensable party and that the cause of action was in the plaintiff, and it re-

linquished any right to the cause of action in favor of the plaintiffs (R. 11). The motion to dismiss admitted this allegation. The opinion says (R. 56, 57):

> "This statement of the Master in his report, which was approved by the court, indicates clearly that the Master believed that the 'cause of action' if any, asserted by plaintiffs in their Complaint, was an asset or property of the debtor, and that the petition for leave to make the debtor a party to the civil action, which was before him for consideration, was, in effect, a request on the part of plaintiffs, for the 'bankruptcy court to surrender to another court (in this instance the District Court) its jurisdiction over the debtor or its property.' This request was denied by the bankruptcy court, as shown by its order denying plaintiffs' petition. It is, therefore, apparent that the bankruptcy court considered the 'cause of action' if any, asserted in plaintiffs' Complaint to be an asset of the Debtor and, by its order, it refused to surrender to the District Court its jurisdiction over Debtor or its property."

The error is apparent. The Court, in the 77B proceedings, was confronted with the question whether the Debtor was a proper, necessary or indispensable party *to the cause as asserted* in the complaint. *The question for its determination was whether under the cause of action as stated in that complaint* the Debtor was a proper, necessary or indispensable party.

(1) The question whether the Debtor was a proper party depended upon the asserted cause of action in the complaint and upon no other cause or showing, and the determination that it was not a proper party constituted an adjudication.

The question whether the Debtor was a necessary party depended *on the allegations of the complaint* and

not on any other allegations or showing (Volume 13, Fletcher, Cyclopedia Corporations, Section 5912). If the Master and the Court believed that the "cause of action" *as "asserted"* in the complaint was *"an asset or property"* of the Debtor, *they could not have concluded,* as they did, that the Debtor, was neither a proper, necessary nor indispensable party. If it appeared from the "asserted" cause of action that the property was "an asset of the Debtor," as stated in the opinion, the Bankruptcy Court *could not have arrived at the conclusion that the Debtor was neither a proper, necessary, nor indispensable party.*

(2) If the action as asserted in the complaint was derivative from the Debtor, the Bankruptcy Court could not have concluded that the Debtor was not even a proper party as such a Debtor is an indispensable party.

A Trustee vested with a legal title to the property which is an asset of the bankrupt estate is an indispensable party (Remington on Bankruptcy, Section 2331). *The only justification for the order holding that Debtor was not even a proper party can only be reconciled with the theory that the cause of action did not belong to it;* that it had no right, title or interest therein and that it was therefore an improper party. True, the Master stated (R. 26) that no showing was made that the Debtor was a necessary party. *The request for leave to join the Debtor as a party was based on the complaint. No other showing was necessary or proper.* The conclusion of the Master and the affirmance of his report by the Court that upon the cause of action as stated in that complaint The Terminals Company was not a proper, necessary or indispensable party *can only be reconciled with a determination that the cause of action "as asserted"* was vested in the creditors and not in the Debtor. No proof is necessary for a determination

as to the capacity of a party to sue when the matter is presented to the Court on the pleadings (42 Corpus Juris, p. 494, Par. 492). The Court was called upon to determine whether under the cause of action as alleged in the complaint the Debtor was a proper party. *It was confronted with the cause of action as there alleged and with no other cause of action. When that Court concluded, determined and adjudicated that under the cause of action as stated in that complaint the Debtor was not even a proper party, it thereby adjudicated that the cause of action did not belong to it but belonged to the creditors.* The order must be given such a construction which is consistent and in harmony with the laws (34 C. J., page 502).

The statement in the opinion that the Bankruptcy Court determined that the Debtor was not a proper, necessary or indispensable party because no such allegation was made by the complaint is, of course, *contradicted by the complaint* which alleged that the Debtor "should be joined either as plaintiff or defendant" (R. 19). *An allegation that a party should be joined cannot be read as an allegation that the party is not a proper, necessary or indispensable party.* Whether the Debtor was a proper, necessary or indispensable party was presented to the court *on the face of the pleadings.* If the cause of action was a *derivative* one, the Debtor was an *indispensable* party and it was the duty of the court to so adjudicate from the face of the pleadings (*Carey* v. *Brown,* 92 U. S. 171), and the Court could not have dispensed with the joinder of an indispensable party (*State of Washington* v. *United States* (9th Cir.), 87 F. (2) 421). When the District Court concluded in the 77B proceedings on the face of the pleadings that the cause of action "asserted in the complaint" did not warrant the making of The Terminals Company as a party and it was not even a proper party, *it necessarily deter-*

mined that the cause of action was not a derivative one and that the action was properly commenced by the plaintiffs as creditors.

(3) Even if the action is derivative it was proper to join the Debtor in an action by creditors, and the determination that the Debtor was not even a proper party constituted an adjudication that the action was not derivative.

Even in a derivative cause of action it is not improper for creditors and the corporation to be joined as parties plaintiff (*Hanna* v. *Brictson Manufacturing Co.* (8th Cir.), 62 F. (2) 139, 144), and when the court concluded that it was not necessary to join the Debtor as a party it determined that the action was not in the Debtor and therefore it was not a proper party.

(d) Even if the cause of action belonged to the Debtor the jurisdiction was relinquished in favor of the plaintiffs as creditors, and the cause of action was properly brought by them, and the order of dismissal should be reversed.

Even if the cause of action was derivative and belonged to the Debtor which was administered under the exclusive jurisdiction in the 77B proceedings the Court in that proceeding *had the right to relinquish the jurisdiction in favor of the creditors,* and such jurisdiction was relinquished by its order that the Debtor was neither a proper, necessary nor indispensable party. The issue as to whether or not the Debtor was to be allowed to join was presented to the Bankruptcy Court upon the petition for leave to join based on the complaint, the Debtor's answer and the answer of the Bondholders'

Protective Committee representing the large group of creditors. The answer of The Terminals Company stated (R. 27):

> "that the said alleged cause of action *does not appear to offer sufficient prospects of a recovery and realization to justify the pursuit of the same by The Cleveland Terminals Building Company,* or the incurring of any expenses by The Cleveland Terminals Building Company in an effort to enforce the same."

The answer further stated:

> "If the creditors of The Cleveland Terminals Building Company, who are parties plaintiff in said suit * * * desire to pursue said cause of action on their own responsibility and at their own expense, The Cleveland Terminals Building Company does not wish to place any obstacles in their path."

The answer stated that the Debtor even consented to being made a nominal party if necessary to preserve plaintiffs' cause, provided no expense would be charged to the Debtor (R. 28).

The memorandum of the Committee *representing the creditors* stated that the cause of action clearly belonged to the creditors and not to The Terminals Company (R. 32-33). *Based on this answer and on the position of the Committee,* representing the large group of creditors, which contended that the action belonged to the creditors, the Bankruptcy Court entered its order on November 10, 1939, stating therein that the Subsidiary Debtor was neither a proper, necessary nor indispensable party. *This constituted a relinquishment of the jurisdiction, if it ever existed.*

(1) The Bankruptcy Court under 77B was authorized to relinquish its exclusive jurisdiction and permit the creditors to sue in their own name if such exclusive jurisdiction existed.

Even if the provision in Section 77B be stretched to the *absurdity,* that a *debtor* becomes the representative of the *creditor,* the Bankruptcy Court had the jurisdiction to relieve the Debtor from the conduct of such a litigation and to leave it to the creditor, which it did by the order which adjudicated that it was not a necessary or even proper party. Section 77B(c)(14) provides:

> "In case a trustee is not appointed, the Debtor shall continue in the possession of its property, and, if authorized by the Judge, shall operate the business thereof during such period, fixed or indefinite, *as the judge may from time to time prescribe,* and shall have all the title to and shall exercise, consistently with the provisions of this section, all the powers of a trustee appointed pursuant to this section, subject at all times to the control of the judge, and *to such limitations, restrictions, terms and conditions as the court may from time to time impose and prescribe."*

The Bankruptcy Court therefore was authorized to relinquish its jurisdiction.

(2) The jurisdiction was relinquished by the order that the Debtor need not be made a party.

When the application was made to the Bankruptcy Court for leave to join The Cleveland Terminals Building Company as a plaintiff or defendant and when the Court entered its order denying the right to join on the ground that *it was neither a necessary nor proper party* it thereby *limited its jurisdiction to the administration*

of the estate to the *exclusion* of the cause of action involved. The reason for the relinquishment of the jurisdiction may be due to the answer of the Debtor which stated (R. 27) that "said alleged cause of action does not appear to offer sufficient prospect of recovery and realization to justify the pursuit" by the Debtor.

In *Rosenblum* v. *Dingfelde,* 2 Cir., 111 F. (2) 407, the Court said that the abandonment of an asset by a trustee operates as if the trustee "never had title to it." If such asset was in the possession of the bankrupt and if he was discharged, the asset would not be subject to claims of creditors. Here, there was no discharge. The asset was in the possession of third parties and the creditors had the right to proceed to enforce this claim.

III.

The suit against the nonresidents in Ohio was under no possible theory an interference with the administration of the bankruptcy estate in the 77B proceedings, and if the dismissal of the cause will be sustained such cause will be forever lost to the plaintiffs as well as to the entire estate.

The cause of action accrued September 30, 1935. No action was ever taken by The Terminals Company prior to the commencement of the 77B proceeding. The Terminals Company was in business from September, 1935, when the sale was held, up to the latter part of 1936 when the 77B proceedings were invoked. After the commencement of the 77B proceedings, when it was allowed to remain in possession, *it failed to take any action on the asserted cause of action* up to the present time. Over five years have elapsed and no action was ever commenced by the Debtor. *The period of limitation in Ohio, where the cause originated, is four years.* The original action by the plaintiffs was commenced in Ohio within

the statutory period, and if it be held that the plaintiffs, as creditors, may not maintain the action, *then by virtue of the intervention of the Statute of Limitations the entire cause of action will be forever lost* (R. 41). If the Debtor be construed to stand in the position of a Trustee for creditors it was negligent and guilty of laches in not commencing the action within the period of the Statute of Limitations, and *creditors should not be prejudiced by the legal fiction which places the party* which committed the fraud in the capacity of the prosecutor on behalf of the defrauded party.

(a) Section 77B was not enacted for the purpose of permitting a corporation to initiate proceedings for alleged reorganization purposes as a means to deprive creditors of their rights and remedies indefinitely.

Section 77B was not enacted for the purpose of permitting a corporation to initiate proceedings for alleged corporate reorganization and thereby deprive the creditors of their rights and remedies indefinitely (*Re*: *Utilities Power and Light Corporation,* 7th Cir., 91 F. (2) 598). *From 1935 to 1941 no action was ever commenced by the corporation for the benefit of the creditors.* The corporate fiction ought not to be used for the purpose of depriving creditors of their rights and remedies. *In such cases the courts will ignore the corporate fiction and permit the creditors to proceed with remedy* (*Clark* v. *Miller,* 142 Pac. 918, 929 (Cal.)). The cause of action was based on a fraudulent conspiracy between the directors of The Terminals Company and the other defendants in forming the Midamerica Corporation and in acquiring the assets on September 30, 1935.

(b) The Statute of Limitations having intervened, no other cause of action may be maintained, and the cause of action will be forever lost to the entire estate.

A cause of action of this nature is not founded under the Bankruptcy Act but is founded *on the peculiar law of the State of Ohio* which adopted the theory, not uniform in all States, that directors of an insolvent corporation are trustees not for the corporation but for the creditors. The Statute of Limitations in Ohio for such a cause is four years. As against the Debtor which was a party to the fraud and which knew of all of the facts *a defense of laches may also be asserted.* A Court of Bankruptcy which is essentially a court of equity, ought not to lend its aid to permit the parties to the fraud to place obstacles in the path of creditors and to make available to such parties technical defenses. Even if there be a doubt whether the Statute of Limitations applies, the Court should not speculate with substantial rights and subject them to this doubt. Prior to the amendment of 1938 there was a conflict between the several Circuits as to whether the Statute of Limitations could be urged against the Trustee in Bankruptcy. In *Meikle* v. *Drain,* 9th Cir., 69 F. (2) 290, the Court held that the Statute of Limitations may be interposed. In *Charlesworth* v. *Hebsh, Inc.,* 8th Cir., 84 F. (2) 834, the Court also applied the Statute of Limitations against a bankruptcy trustee.

(c) The defense of laches may be available against the Debtor, and the rights of the Creditors should not be prejudiced by making such defenses available.

The defense of laches may be avaliable against a Trustee who delayed an action for over four years. *It is*

certainly available against the Debtor which neglected the cause of action for an entire year before it invoked the aid of the Court in Bankruptcy. (*Walpert* v. *Cripton,* 2 Pac. (2) 267; 213 Ga. 474; Remington on Bankruptcy, 1939 Supp., Sec. 2344, p. 55.) The defense of laches may be interposed even in bankruptcy (Remington on Bankruptcy, Sec. 2335.25).

IV.

The fraud of Midamerica Corporation was adjudicated. The recovery from the defendants is clear. The rights of the creditors should not be sacrificed on the legal fiction that the debtor instead of the creditor is entitled to maintain the action.

Subsequent to the filing of the original complaint in Indiana a Supplemental Amendment was filed by leave of court. In that Supplemental Amendment it was alleged, among other things, that after the filing of the complaint it was adjudicated in the 77B proceedings that "Midamerica" was conceived in fraud, and the "purchase" at the "Morgan" sale was in combination with the Trustees who violated their Trust. This involved the claim filed by Midamerica Corporation predicated on the purchase of notes executed by the Debtor in the amount of $13,787,000.00 at the alleged public sale at the cost to Midamerica of $887.00 and the purchase of another claim of $1,348,614.99 at the sum of $2.00 (R. 37).

These findings were made upon the objections of the appellant, A. B. Gochenour (R. 37, Par. 2). The District Court approved the Master's Report (R. 38). It follows from the foregoing findings that the creditors were defrauded, and the defendants in the Indiana suit, who are not innocent parties, but who received the spoils in excess of $6,000,000.00 from Midamerica Corporation, with notice of the facts and as parties to the fraud, are liable

to account, and the assets are charged with the trust in favor of the creditors. The Indiana defendants who joined with the fiduciaries of the Debtor to create the Midamerica Corporation, to purchase the collateral for their personal gain were jointly and severally liable for the profits realized by them from the sale of the collateral (*Irving Trust Co.* v. *Deutch*, 73 F. (2) 127, C. C. A. 2; *Ripperger* v. *Allyn*, 25 F. Supp. 554, 555; *Chappel* v. *First Trust Co.*, 30 Fed. Supp. 763, 764). This clear liability of the defendants and the assets sought to be recovered will be completely lost by the *myth* that the Debtor, which was a party to the fraud, had the right to maintain the action although it stood by and failed to take any action from 1935 to 1941. The sacrifice of the rights of the creditors predicated on this judicial myth is contrary to conscience, and we hope that this Court will remove these legal technicalities and pave the way for justice to be done, and will grant the writ.

For the foregoing reasons we respectfully submit that the Writ of Certiorari should be awarded so that the order of the District Court which was affirmed by the United States Circuit Court of Appeals for the Seventh Circuit may be reversed.

Respectfully submitted,

MEYER ABRAMS,
JOSEPH L. STERN, and
HARRY J. MYERSON,
Attorneys for Petitioners.